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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1958

No. 685

EZRA ROYCE, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit.

## OPINIONS BELOW

The opinion of the Tax Court (R. 263-278) is not officially reported. The opinion of the Court of Appeals (Appendix A, *infra*, pp. 1a-13a) is not yet officially reported.

## JURISDICTION

The judgment of the Court of Appeals was entered on November 10, 1958. (Appendix B, *infra*, p. 13a.) The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

## QUESTIONS PRESENTED

The following questions are presented:[1]

(1) Where a wife concededly owns a capital interest in a partnership and regularly contributes services to it, may her share of the firm earnings nevertheless be taxed to her husband on the ground that she is not a partner for income tax purposes.

(2) Where a wife concededly owns a capital interest in a partnership, to which neither she nor her husband contributes services, may her share of the firm earnings nevertheless be taxed to her husband on the ground that she is not a partner for income tax purposes.

## STATUTES INVOLVED

Internal Revenue Code of 1939:

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * *

[1] The opinion below dealt with a number of other issues which are not involved here.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership .... (26 U.S.C. 1952 ed., Secs. 181, 182.)

## STATEMENT

This petition involves two partnerships—one doing business in Portland, Oregon, and the other in Seattle, Washington. The facts relating to each may be summarized as follows:

### Portland Partnership

In 1942 the petitioner was a stockholder in Yellow Cab Incorporated, an Oregon corporation doing business in Portland, Oregon. (R. 263, 641.) On July 31, 1942, he transferred slightly less than half of his stock to his wife Dora F. Royce. (R. 641.) The following day the corporation was dissolved, and the stockholders formed a partnership to operate the business as Yellow Cab Company. (R. 263-266, 641.)

The partnership was organized under written articles executed by all the prior stockholders, including Dora. Under the terms of the agreement the partners assumed the liabilities of the corporation. The partnership was to "continue for the duration of the joint lives of the parties," unless otherwise dissolved by them. Its stated capital consisted of the assets formerly owned by the corporation plus undistributed income. Profits and losses were to be shared by the partners in proportion to their relative interests. Each partner had "an equal voice in the control of the business and operation of the partnership." The partnership was required "to keep accurate books of account," which were to be open to all the partners. Upon dissolution of the firm the surplus was to be divided among them according to their interests. (R. 263-266.)

Dora and the petitioner were married in 1923. (R. 387.) She was a woman of substantial business experience. Before marriage she had been a millinery designer and held positions of responsibility. Her business background included the executive supervision of employees, as well as control of overhead and other expenses. (R. 447-448, 527-528.)

During the taxable years Dora and the petitioner were the only working partners. (R. 272, 518, 641-642.) As managing partner, the petitioner made the day-to-day decisions in the operation of the business. (R. 641.) Since he had numerous other activities, he only spent about half of his time there. (R. 641.)

Dora regularly rendered services to the partnership as a checker. She checked the conduct of the drivers, the appearance of their uniforms, the condition of the cabs, and the number of passengers carried. She performed these services at hotels, stands, depots and other places where cabs regularly picked up or discharged passengers. Her observations were recorded in reports which she filed at the office. (R. 641.) The hours devoted by Dora to her checking varied. Often she would work all day. On other occasions she would work less. At times she did her checking in the evening. She was experienced in her work because she had performed the same services for the prior corporation. (R. 641-642.) Now and then the petitioner did some checking. (R. 642.) In the absence of Dora's services the partnership would have had to employ a checker to do her work. (R. 642.) Dora also attended conferences of the partners and expressed her views. (R 642.) Whenever there was a distribution of profits, Dora received her share. (R. 430, 454.) All distributions to her were in the form of checks payable to her.

(R. 273.) She maintained a separate checking account at The First National Bank of Portland. (R. 273-274, 431, 535.) She never had a joint checking account with the petitioner. (R. 449, 455, 536.)

The drawing accounts of Dora and the petitioner on the books of the partnership show the following withdrawals during the taxable years 1944 through 1947 (R. 272):

| Year | Dora | Ezra |
|---|---|---|
| 1944 | $ 48,777.75 | $ 58,184.94 |
| 1945 | 69,180.00 | 80,820.00 |
| 1946 | 48,865.01 | 57,086.99 |
| 1947 | 4,612.00 | 5,388.00 |
| Total | $171,434.76 | $201,479.93 |

Dora exercised her own judgment in spending or investing her funds. (R. 466-467, 535-536, 552-553.) She spent about $1,850 for two fur coats, $8,000 for two Chrysler automobiles, $350 for an exercycle, $1,800 for silverware, and $400 for lace cloth. In addition, she bought a Plymouth and Cadillac, purchased various furnishings for the home, acquired several hundred dollars worth of books, and spent about $18,000 in improvements of the house. (R. 275, 431-433, 467, 531-533.) The petitioner provided for ordinary household expenses, such as food, light, heat, groceries, insurance, and taxes. (R. 433-434, 533.)

Dora invested $7,000 in Government bonds and $2,500 in Missouri-Pacific stock. (R. 275, 433, 456.) These securities were acquired in her own name. (R. 455-456.) She loaned about $70,000 to the petitioner for investment in Alder Gold-Copper Company. (R. 275, 456-463, 542, 552.) The petitioner was interested in

the promotion of that corporation, and in 1949 he acquired about 5 percent of its common stock. (R. 214-215, 457-458, 460-463, 484, 489, 551-552.) Dora also had stock in the corporation. (R. 457-458.)

The Commissioner determined that Dora was not "a bona fide partner" in the Portland partnership, and taxed her share of the partnership profits for the years 1944-1947 to the petitioner. The Tax Court sustained the Commissioner's adjustments and the resulting deficiencies. (R. 275-278.) The Court of Appeals affirmed the conclusion of the Tax Court. (R. 641-642.)

**Seattle Partnership**

Yellow Cab Company of Seattle was a Washington corporation. (R. 642.) Its stockholders were the petitioner and six other individuals. (R. 266.) On April 20, 1944, the petitioner transferred a portion of his shares to Dora. (R. 642.) He duly filed a gift tax return and paid a gift tax. (R. 267.)

On May 1, 1944, the corporation was liquidated and dissolved. (R. 642.) On the same day a partnership was formed to carry on the business previously conducted by the corporation. (R. 266-271, 642.) The firm consisted of ten members. (R. 642.) The interest of the petitioner was about 5 percent, and the interest of Dora about 7 percent. (R. 642.) Under the Articles of Copartnership the initial term of the partnership was five years. It was to continue for similar successive periods unless any partner gave notice to the contrary. Its capital consisted of the assets of the dissolved corporation, subject to its liabilities, which the partners assumed. (R. 267-269.)

Neither the petitioner nor Dora was active in the business. (R. 642.) Another partner was in direct

charge of the enterprise and performed all the duties of management. (R. 642.)

Dora received her proportionate share of firm distributions together with the other partners. (R. 439-440, 465-466, 619.) All distributions to her were made by checks payable to her. (R. 465, 618-619.) For the years 1945 through 1949 the withdrawals of Dora and the petitioner from the Seattle partnership were as follows (R. 272-273):

| Year | Dora | Ezra |
|---|---|---|
| 1945 | $41,622.53 | $30,994.97 |
| 1946 | 19,662.53 | 14,644.97 |
| 1947 | 12,342.53 | 9,194.97 |
| 1948 | 12,342.53 | 9,194.97 |
| 1949 | 5,022.53 | 3,744.97 |
| Total | $90,992.65 | $67,774.85 |

At the time of trial the partnership had suffered losses for two years. Dora's account was charged with her share of the losses. (R. 621.)

The Commissioner determined that Dora was not "a bona fide partner" in the Seattle partnership, and taxed her share of the partnership profits for the years 1945-1947 to the petitioner. The Tax Court sustained the Commissioner's adjustments and the resulting deficiencies. (R. 275-278.) The Court of Appeals affirmed the conclusion of the Tax Court. (R. 642-643.)

## REASONS FOR GRANTING THE WRIT

The Court of Appeals has held that Dora's share of the profits of each partnership was taxable to the petitioner on the ground that she did not qualify as a partner for income tax purposes. The applicable stat-

utes are sections 181 and 182 of the Internal Revenue Code of 1939. Section 181 states, "Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity." Section 182 provides that each partner shall report his distributive share of the income or losses of the partnership. This Court has authoritatively construed these statutes in *Commissioner* v. *Culbertson*, 337 U. S. 733 (1949).

The *Culbertson* case articulates four basic rules. First, the concept of partnership in income tax law is precisely the same as the concept of partnership in commercial law. "A partnership is, in other words, an organization for the production of income to which each partner contributes one or both of the ingredients of income—capital or services." 337 U. S. at 740. The question is "one concerning the bona fide intent of the parties to join together as partners;" and a party reflects the requisite intent by contributing either services or capital. *Id.* at 743, 748. Or, as Mr. Justice Frankfurter stated in his concurring opinion, so-called family partnerships are not to be disregarded "as partnerships for income-tax purposes even though they be genuine commercial partnerships." The term "partnership" in sections 181 and 182 does not have "a content peculiar to the Internal Revenue Code." The customary criteria which determine the existence of a partnership also "apply in tax cases when the Government challenges the existence of a partnership for tax purposes." "In plain English, if an arrangement among men is not an arrangement which puts them all in the same business boat, then they cannot get into the same boat merely to seek the benefits of §§ 181 and 182. But if they are in the same business boat, although they may have varying rewards and

varied responsibilities, they do not cease to be in it when the tax collector appears." *Id.* at 750-752, 754.

Second, if a partner contributes services to the enterprise, the question is not whether the services "are of sufficient importance to meet some objective standard," but whether the services indicate an intention to join the enterprise. *Id.* at 742. Third, regardless of services the donee of an intra-family gift can "become a partner through investment of the capital in the family partnership." *Id.* at 745. "Original capital" is not "an essential test of membership in a family partnership." *Id.* at 748. Whether the donee has made an investment of gift-capital depends on whether the gift is a true transfer of a participating interest or "mere camouflage." *Id.* at 746-747. Fourth, if partners have "agreed that the services or capital to be contributed presently by each is of such value to the partnership that the contributor should participate in the distribution of profits, that is sufficient." There is "room for an honest difference of opinion as to whether the services or capital furnished by the alleged partner are of sufficient importance to justify his inclusion in the partnership." A court cannot "substitute its judgment for that of the parties." *Id.* at 744-745.

In the light of these controlling criteria the decision below is in direct conflict with *Commissioner* v. *Culbertson, supra,* and decisions of other Courts of Appeals. By the same token, it presents important questions in the administration of the income tax law which should be resolved by this Court.

1. Under the *Culbertson* decision Dora clearly qualified as a member of the Portland partnership because

of the services she continually contributed. The Tax Court agreed that Dora's services were similar to those normally performed by a regular employee. (R. 272.) However, it then tried to dismiss her services by characterizing them as "relatively inconsequential." (R. 277.) In other words, it sought to evaluate Dora's services in response to "some" elusive "objective standard" of its own—the very sort of approach which this Court unmistakably condemned in *Commissioner* v. *Culbertson, supra,* at 742. On appeal the petitioner argued, on the basis of the evidence, that the Tax Court's disparaging description was clearly erroneous as well as legally irrelevant. The Court of Appeals accepted the petitioner's view of the evidence. In the precise words of that Court,

> "Dora Royce regularly acted for the partnership as a checker. She checked the conduct of the drivers, the appearance of their uniforms, the condition of the cabs and the number of passengers carried. She checked at hotels, stands, depots and other places where cabs regularly picked up or discharged passengers. Her observations were recorded in reports which she filed at the office. The hours devoted by Dora to her checking varied. Often she would work all day. On other occasions she would work less. At times she did checking in the evening. She was experienced in her work because she had performed the same services for the prior corporation. Now and then E. Royce did some checking. In the absence of Dora's services, the partnership would have had to employ a checker to do the checking. Dora also attended conferences of the partners and expressed her views." (Appendix A, *infra,* p. 11a.)

These detailed facts, as succinctly summarized by the Court of Appeals, speak very clearly for themselves.

Dora was a working partner actively engaged "in the affairs of the business." 337 U. S. at 747. Indeed, apart from the petitioner, Dora was the only other working partner. In the absence of her services, the firm would have had to employ someone else to perform her duties. The essence of the matter is that husband and wife were working together in accordance with their respective abilities.

Despite its plain-spoken findings the Court of Appeals nevertheless refused to recognize the services of Dora. It did so on the strange ground that her services "were such that any wife who had the interests of her husband's business at heart might perform." (Appendix A, *infra*, p. 11a.) We need not labor the point that serving steadily as a checker of drivers and cabs is scarcely the routine concern of "any wife" in her husband's business. In taxing Dora's income to the petitioner the Court of Appeals clearly departed from the controlling principles of the *Culbertson* opinion.

2. Under the *Culbertson* decision Dora equally qualified as a member of the Portland partnership because of her undisputed capital interest. As the Tax Court found, the petitioner gave Dora a capital interest in the business through a transfer of stock, and she then executed the articles of partnership along with the other members of the firm. (R. 263-266.) Or, as the Court of Appeals stated the facts, the petitioner "transferred to her 14,000 shares, slightly less than half of the stock he owned" in the corporation. After the corporation was dissolved, "a partnership was organized where each partner kept the same percentage of ownership as had been represented by stock in the former corporation." (Appendix A, *infra*, p. 10a.)

Dora's interest in the partnership was no less real than her interest in the corporation. Under the partnership agreement she "had the same legal rights and liabilities as did the other partners with respect to the firm." *Whayne* v. *Glenn*, 222 F. 2d 549, 551 (6th Cir. 1955). The petitioner did not retain any special powers or privileges which rendered her interest illusory. Along with the other partners she had "an equal voice" in the business while the partnership continued, and along with them she was to receive her aliquot share of the surplus when it dissolved. (R. 265.) Whenever distributions were made, she took her portion. See pp. 4-5 *supra*. Dora's interest was as genuine as the petitioner's interest. As the Court of Appeals put it, "by law she had a one-half interest in the proceeds." (Appendix A, *infra*, p. 11a.)

The Courts of Appeals and the Court of Claims have repeatedly held, in strict adherence to the *Culbertson* decision, that a donee of a capital interest in a partnership must be recognized as a partner, regardless of any services which he may or may not perform. See *Lamb* v. *Smith*, 183 F. 2d 938 (3d Cir. 1950); *Ginsburg* v. *Arnold*, 185 F. 2d 913 (5th Cir. 1950); *Seabrook* v. *Commissioner*, 196 F. 2d 322 (5th Cir. 1952); *Heusler* v. *Whitson*, 200 F. 2d 538 (6th Cir. 1952); *Marcus* v. *Commissioner*, 201 F. 2d 850 (5th Cir. 1953); *Nicholas* v. *Davis*, 204 F. 2d 200 (10th Cir. 1953); *Scofield* v. *Mauritz*, 206 F. 2d 135 (5th Cir. 1953); *Estate of Horsey* v. *Commissioner*, 214 F. 2d 294 (5th Cir. 1954); *Scofield* v. *Davant*, 218 F. 2d 486 (5th Cir. 1955); *Fly* v. *Cole*, 219 F. 2d 653 (5th Cir. 1955); *Whayne* v. *Glenn*, *supra*; *Williamson* v. *United States*, 152 F. Supp. 716 (Ct. Cls. 1957).

Though Dora concededly had a capital interest in the firm and "a one-half interest in the proceeds," the Court of Appeals nevertheless refused to respect her as a partner. It attempted to justify its adverse conclusion on the ground that she spent various sums for "family purposes" and made a loan to the petitioner. (Appendix A, *infra*, p. 11a.) In this connection, the evidence discloses, first, that the petitioner continued to pay the ordinary expenses of the household; and, second, that a number of years after Dora acquired her interest in the Portland partnership, she loaned the petitioner $70,000 for investment in a mining corporation.[2] See pp. 5-6, *supra*. Undoubtedly, if the question to be resolved is whether a wife has acquired an interest in a business, the use of the income produced by the interest may be relevant evidence in settling the dispute. But here there is no such dispute on the factual level. The Court of Appeals has specifically held that Dora acquired an interest in the corporation; that she retained "the same percentage of ownership as had been represented by stock in the former corporation;" and that "by law she had a one-half interest in the proceeds." (Appendix A, *infra*, pp. 10a-11a.) Hence Dora's expenditures are immaterial, for they derived from her own choice as owner. Surely a wife does not cease to be a partner because she makes a loan to her husband or buys things for the home. Cf. *Wilson* v. *Commissioner*, 161 F. 2d 661 (7th Cir. 1947); *Lamb* v. *Smith*, *supra*; *Estate of Dorsey* v. *Commissioner*, *supra*. The Commissioner's complaint can only begin and end with the question whether Dora

[2] The corporation was organized in January, 1947. (Ex. 45-SSSS.)

truly owned a capital interest in the partnership. And that question has been resolved against him.

In short, the Court of Appeals has determined that Dora owned a capital interest in the partnership and an interest in the proceeds of the partnership. Its failure to treat her as a partner conflicts with *Commissioner* v. *Culbertson*, *supra*, and the many decisions which conform to it. See p. 12, *supra*.

3. The same conflict exists in regard to the Seattle partnership. Indeed, the conflict is more obvious here, since none of the earnings derived from the petitioner's services. As the Court of Appeals stated the relevant facts, "The firm consisted of ten members." Dora "acquired a capital interest" in the enterprise "through a gift" by the petitioner. Dora's interest was about 7 percent and the petitioner's about 5 percent. Neither the petitioner nor Dora "was active in the business. Another partner was in direct charge of the enterprise and performed all the duties of management." (Appendix A, *infra*, pp. 11a-12a.) Both the petitioner and Dora were simply passive investors in a business whose income stemmed from the capital plus the efforts of others. The income of the firm was no more attributable to the petitioner than to Dora. In these and similar circumstances, where the income is wholly divorced from any services by the donor-partner, the courts until now have consistently concluded that he cannot be taxed on the profits of the donee-partner. See *Jones* v. *Baker*, 189 F. 2d 842 (10th Cir. 1951); *United States* v. *Atkins*, 191 F. 2d 146 (5th Cir. 1951); *T. W. Rosborough*, 8 T.C. 136 (1947); *Arthur A. Byerlein*, 13 T.C. 1085 (1949);

*William Collins, Sr.*, 7 T.C.M. 830 (1948); *Estate of A. C. Hewitt, Sr.*, 9 T.C.M. 383 (1950); *R. G. Bock*, 9 T.C.M. 709 (1950); *Edna Jurgensen*, 9 T.C.M. 1027 (1950); *Juliana Schroeder*, 11 T.C.M. 8 (1952).

If Dora had held an equivalent interest in a corporate enterprise, her ownership would clearly be recognized for tax purposes. Her ownership was no less genuine because the business was carried on through a partnership. A gift of a corporate interest and a gift of a partnership interest are subject to the same rules. *Williamson* v. *United States*, 152 F. Supp. 716 (Ct. Cls. 1957). In the words of Judge Madden, who has concisely summarized the *Culbertson* decision as it affects donee-partners, "One may avoid paying taxes on the future income from his property by the drastic remedy of giving away his property." The gift "may be to anyone at all," and "may be of land, stocks, bonds, or any other kind of property. It may be of a corporate interest or of an undivided interest. The only question pertinent in an income tax case is whether he really gave the property away, or only pretended to give it away in order to escape or reduce the taxes on the income." The same settled principle applies to "shares in partnership as well as to other kinds of property, and even if the partnerships are family partnerships." *Id.* at 719.

In the present case there is no question of pretense or sham. The Court of Appeals has found that Dora acquired a capital interest in the business, and that she was a member of the firm. Hence it plainly erred in concluding that Dora's share of the income was taxable to the petitioner.

4. The Court of Appeals has held here that a partner may be ignored for tax purposes even though he or

she regularly contributes services or owns a capital interest. This decision necessarily raises significant questions, for it seriously unsettles the law relating to so-called family partnerships.

In 1951 Congress enacted special provisions on such partnerships. Revenue Act of 1951, § 340, amending § 3797(a)(2) and adding § 191 of the 1939 Code.[3] These provisions are solely concerned with a partnership interest "created by gift." For present purposes they state that an individual "shall be recognized as a partner for income tax purposes if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person." The legislation of 1951 does not in any way diminish or curtail the significance of the questions involved here. First, it does not in the least affect the status of those who otherwise qualify as partners by contributing personal services. Second, it merely reiterates the pre-existing law in regard to those who qualify through a gift of a capital interest. If the decision below is correct, then it equally applies to the legislation of 1951. See H. R. Rep. No. 586, 82d Cong., 1st Sess. 32, 33 (1951); Sen. Rep. No. 781, 82d Cong., 1st Sess. 38, 39 (1951); *Alexander* v. *Commissioner*, 194 F. 2d 921, 923-924 (5th Cir. 1952); *Toor* v. *Westover*, 200 F. 2d 713, 716 (9th Cir. 1952); *Parker* v. *Westover*, 221 F. 2d 603, 607 (9th Cir. 1955). Hence the questions posed by the decision below radiate continuing problems which require the thoughtful consideration of this Court.

[3] The provisions have been continued in Int. Rev. Code of 1954, § 704(e)(1).

5. There is no question of fact to be unravelled here. With respect to the Portland partnership the Court of Appeals has found that Dora regularly contributed services and owned a capital interest. With respect to the Seattle partnership the Court of Appeals has found that Dora owned a capital interest and that none of the firm's earnings was attributable to services of the petitioner. (Appendix A, *infra*, pp. 10a-12a.) And so the two questions presented here are sharply defined issues of law which are unembarrassed by any difference over evidentiary details. They derive from the Court of Appeals' failure to apply the appropriate criteria of judgment as carefully enunciated in *Commissioner* v. *Culbertson, supra*. If those criteria are not faithfully followed, the *Culbertson* opinion becomes a meaningless essay, and the governing principles of law disappear into a morass of disparate adjudications. A just system of taxation presupposes the existence of intelligible rules of law which are uniformly applied.

Unless the criteria of the *Culbertson* opinion are to be ignored, Dora was clearly a member of both partnerships. She and the other partners were "in the same business boat." She did "not cease to be in it" because the Commissioner appeared on the scene. 337 U. S. at 754.

## CONCLUSION

For the foregoing reasons the petition for a writ of certiorari should be granted.

Respectfully submitted,

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## APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 15,724

November 10, 1958

FRED C. NIEDERKROME, E. ROYCE, DORA F. ROYCE, EZRA ROYCE, B. ROYCE, ESTATE OF ISABELLE H. ROYCE, DECEASED, B. ROYCE, Executor, ROBERT T. JACOB, AGNES C. JACOB, ALBERT L. SCHNEIDER and BERTHA SCHNEIDER,
*Petitioners,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

Upon Petitions to Review Decisions of The Tax Court of the United States.

Before: HEALY, FEE and HAMLEY, Circuit Judges

JAMES ALGER FEE, Circuit Judge:

This action for review of the determination of tax deficiencies involves several problems:

1. Did the distribution of earnings by a corporation in payment of a note and the simultaneous redemption of 350 shares of stock purchased with the proceeds of the note constitute a distribution equivalent to dividends?

2. Did the payment or disbursement of incidental expenses to the company making the loan furnish any evidence of the intention?

3. Did the Tax Court err in admitting the minutes of the corporation making the loan?

4. Was a $20,000.00 disbursement by a different corporation to its stockholder a loan or a dividend and taxable?

5. Was the finding that a wife was not a bona fide partner in two different partnerships correct?

6. Where a partner declared a trust for his minor daughter and appointed himself trustee for her, but treated the proceeds as if he were the owner, did the "trust" prevent taxation of the whole as his interest?

*Oregon Motor Stages*

Oregon Motor Stages was a corporation operating an intrastate bus line as a common carrier. The outstanding capital of this corporation consisted of 750 shares, which the stockholders at that time insisted should be purchased as a unit. E. Royce, B. Royce, Robert T. Jacob and Albert L. Schneider were advised all the stock was thus for sale and signified their willingness to purchase 400 shares at $1,000.00 per share. After various attempts to find purchasers for the balance, 350 shares, L. R. Bentson received the certificates for these shares. Before June 20, 1945, E. Royce made an application to American Business Credit Corporation, an Oregon corporation for a loan of $350,000.00, which corporation transmitted this application to its parent company, American Business Credit Corporation of Delaware. The minutes of an executive committee meeting of the latter corporation regarding this matter were admitted by the court. The 750 shares were sold and purchased July 2, 1945. The persons first mentioned took 400 shares and Bentson the balance.

On the same day, ABC issued its check to L. R. Bentson and E. Royce for $350,000.00, and these persons gave a note for the amount due on or before ninety days from date. Oregon ABC billed Oregon Motors for $4,315.07, servicing fee for financing the loan. The invoice was approved by E. Royce and was paid by Oregon Motors on

July 19, 1945, and charged to its expense account. All certificates were turned over to Oregon ABC to secure the loan of $350,000.00. Bentson gave receipt for the stock of each of the other shareholders reciting "such stock being loaned to me to be pledged to American Business Credit Corporation as collateral to loan this day made to me for the purchase of Three Hundred Fifty (350) shares of the common capital stock of said company." On August 31, 1945, Bentson offered to Oregon Motors his 350 shares. Oregon Motors purchased this stock by check to Bentson for $350,000.00, which was endorsed to Oregon ABC in payment of the original loan. Oregon Motors debited surplus with $315,000.00 and capital stock with $350,000.00, and paid interest on the loan to Oregon ABC and the payment to expense.

The question is whether the stockholders other than Bentson received a dividend by this transaction.

The decision by the Tax Court of the issues upon this phase of the matter was warped by two errors of approach. First, that court held that the determination of the Commissioner was evidence to be weighed against that produced by taxpayers. This is fundamental error. We have consistently held that determination by the Commissioner raises a presumption of correctness which disappears once evidence which would support a contrary finding has been adduced in the trial of a contested issue.[1] Second, the Tax Court admitted in evidence the purported minutes of a meeting of ABC Delaware executive committee and considered these binding upon taxpayers. There was no testimony that these were the minutes of that body. There was an affidavit dated April 25, 1955, stating that affiant, Stuart A. Wixson, is treasurer and assistant secretary of

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[1] Lawrence v. Commissioner of Internal Revenue, 9 Cir., 143 F. 2d 456; San Joaquin Brick Co. v. Commissioner of Internal Revenue, 9 Cir., 130 F. 2d 220, 225.

Crown Finance Company, Inc., formerly ABC Delaware and that three attached pages comprise a copy of the minutes of a meeting held June 20, 1945, by the executive committee of ABC Delaware. The Tax Court hears and decides cases under rules of evidence which apply in the District of Columbia.[2] It is obvious such an affidavit was not in itself admissible under these rules. Even if this document were admissible, it laid no foundation for the introduction of the minutes of an executive committee of ABC Delaware as against taxpayers who were not present, even according to the purported minutes.[3] The whole recorded transaction was one between the parent corporation and its Oregon subsidiary. There was no proof that the record was made in the regular course of business.[4] No witness testified as to the authenticity.[5]

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[2] Internal Revenue Code of 1939, § 1111; Internal Revenue Code of 1954, § 7453.

[3] The records of a corporation "are not competent evidence against third persons to prove contracts with them, in the absence of proof that they knew and assented thereto." Oregon & C.R. Co. v. Grubissich, 9 Cir., 206 Fed. 577, 580. The expression "not necessary to decision" in the following case is pat: "Corporate books of account are not competent against a stranger merely because they are the books of the company whose dealings they purport to record." United States v. Feinberg, 2 Cir., 140 F. 2d 592, 596.

[4] The case of Bruce v. McClure, 5 Cir., 220 F. 2d 330, 335, contains the following quotation from 65 A.L.R.: "The general rule is that before the books of a corporation are admissible in evidence their authenticity must be shown. It must be made to appear that they are the books of the corporation, that they have been kept as its records, and that the entries made therein were made by the proper acting officer for that purpose • • •."

[5] There was a stipulation which established that the record was that of the parent company, that it was in appropriate custody and that it was a true record of the meeting which it purported to record, but this stipulation did not cure the other defects pointed out or make it competent, relevant or material against taxpayers. See Parish's Estate v. Commissioner of Internal Revenue, 7 Cir., 187 F. 2d 390, 395-396.

The purported minutes do refer to a loan of $350,000.00 which was eventually made by the subsidiary ABC Oregon, but the transaction had not been consummated when this supposed meeting was held and was only in the negotiation stage. It was never carried out in the form here outlined, since there was another party to the note, as the event proved.

The ultimate ground of claimed admissibility is 28 U.S.C.A. § 1732.[6] But this entry does not come within terms of the statute. There is here no "memorandum or record of any act, transaction, occurrence or event." This writing purports to be nothing but the record of a transaction between parent and subsidiary corporations. At best it is an interoffice memorandum.[7] It was not the intention of the statute to permit the sewing circle chatter of secretaries about an office party, recorded in the regular course of business of the corporation itself, to bind outside parties as if the latter had made admissions. In any event, the taxpayers who are sought here to be charged were neither parties to the transaction purportedly recorded nor to the conversation set down. All prior negotiations to a written contract are merged therein, even between the parties. The exhibit was therefore entirely inadmissible from any viewpoint.

On account of these errors, the cause must be reversed and remanded to the Tax Court for reconsideration. There are questions of fact involved which that tribunal should

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[6] "* * * any writing or record, whether in the form of an entry in a book or otherwise, made as a memorandum or record of any act, transaction, * * * shall be admissible as evidence of such act, transaction, * * * if made in the regular course of any business, and if it was the regular course of such business to make such memorandum or record at the time of such act, transaction * * * or within a reasonable time thereafter." 28 U.S.C.A. § 1732.

[7] Standard Oil Company of California v. Moore, 9 Cir., 251 F. 2d 188, 212-217, cert. den., 356 U.S. 975.

determine without placing extra burdens on taxpayers. The supposed necessity of meeting and overcoming a presumption of correctness of the determination of the Commissioner was heavy. And it is difficult to explain how the taxpayers could avoid prejudice in attempting to overcome the contents of the purported minutes, which were pure hearsay as to all parties in this case. Judicial officers required to winnow the wheat of pertinent evidence from the chaff of extraneous circumstance should have attached no weight or importance to this exhibit.

But these errors seem to have deflected the Tax Court from the real question in the case. It seems to have been the rationale of that body that, if it were proved that Bentson was acting on the suggestion of the other stockholders and not as an independent investor, taxpayers are liable.

However, the questions which should be tried arise from the face of the statute and the regulations. This Court will not attempt to decide such questions, but will simply outline certain considerations which may have a bearing. The former stockholders of this corporation acquired all the financial benefit of this transaction. By the sale, they received the cash for which they could have been taxed if they had withdrawn the surplus in the form of a pro rata distribution. But, although these persons have received such profits, there is no method of taxing them under the statute.

Taxpayers were unwilling to purchase more than 400 shares of stock, and attempted to find purchasers for the remaining 350 shares. Taxpayers decided to have the corporation acquire these remaining shares. The selling group were willing to proceed in this way, as they still received the full financial benefit of the transaction. An agreement to carry this plan into effect had been drafted when Bentson decided to purchase. It is problematical as

to who, if anyone, would have been liable for tax if this agreement had been carried out as planned.

If a single stockholder of the selling group had owned these 350 shares, he might have retained the block or sold it to a third person. There need be no speculation as to whether either the one who retained the stock or the purchaser from him would be liable for tax if the shares were thereafter retired by the corporation.

"A cancellation or redemption by a corporation of all the stock of a particular shareholder, so that the shareholder ceases to be interested in the affairs of the corporation, does not effect the distribution of a taxable dividend."[8] On its face, such was the transaction here. Oregon Motors redeemed the 350 shares of stock owned by Bentson. Undoubtedly, if he had had no connection with the purchasing group, there would have been no tax upon anyone.

The Tax Court addressed itself, on account of the erroneous approach above pointed out, to a hypothetical demonstration of collusion between Bentson and the other stockholders of the purchasing group.

The real question is whether the taxpayers received any financial or economic benefits as a result of the redemption of the stock of Bentson. Upon this question the Tax Court made no findings. The proposition contains questions of fact. Until findings are made, the conclusions of law cannot be stated.

It can be argued that taxpayers got full control of the corporation. But should this circumstance, standing alone, be considered an economical or financial advantage? It may be considered whether the fact that, by payment of the note, the stock of each of the remaining taxpayers was released from pledge or lien gave them a pertinent advantage.

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[8] Internal Revenue Code of 1939, as amended, Regulations 118, § 39.115(g)(1)(a)(2).

Balancing this is the consideration that the stock redeemed was worth the amount of the note without interest. The payment of the interest by the corporation probably represents some loss to each taxpayer.

It may be said that the corporation must be differentiated from its stockholders. If the corporation owned $400,000.00 worth of assets and a surplus not necessary for its business of $350,000.00, which could have been paid out in dividends, then, by the sale for $750,000.00, the new stockholders acquired all this property. When the corporation paid out the surplus over that required by its business necessities, someone got a dividend. Therefore, it is said the taxpayers received value by the distribution. It seems this argument probably loses sight of its first postulate. It would not be the corporation which was sold, but the stock.

It must be considered then what economic or financial benefit taxpayers received, if any. The stock which they individually purchased was apparently not increased in value by the redemption. In fact, the corporation made incidental payments on this loan amounting to $8,054.80, which consisted of a service fee and interest. If these are obligations of Bentson, as they purport to be, how does their satisfaction constitute a dividend to the other stockholders? But, even if the payment of this fee and interest by the corporation impels the conclusion that these incidental expenses, and therefore the loan itself, were in reality the personal obligation of the remaining stockholders, would not these expenses, incident to a loan, be deductible by these stockholders as such? The question is raised whether the payment of such incidental expenses furnished evidence of an intention of the taxpayers. Here the doubt of the relevance of such intention is pertinent. The real question may well be whether there could be a dividend under the circumstances.

It is apparently held recently that there must be some real financial or economic value to the remaining stock-

holders in the redemption of the holdings of another before a tax is due from the former. Holsey vs. Commissioner, 3 Cir., __ F.2d __.[9] Schmitt vs. Commissioner, 3 Cir., 208 F.2d 819. It is true the case of Zipp vs. Commissioner, 6 Cir., __ F.2d __, held that, where a majority stockholder sells his stock to minority stockholders, who use corporate funds to pay therefor, the sum paid is taxable as a dividend to those who purchase. However, in the case at bar, the taxpayers did not buy or agree to buy the stock. The Zipp holding has been severely criticized. And it has been said that, if there had been no sale to stockholders, a dividend determination could have been avoided by the remaining stockholders.[10]

The shares of stock in this corporation apparently became immensely more valuable in the hands of the selling stockholders. However, when they sold, they were subject to tax on whatever profit they realized thereon. During the years when this surplus was accumulated, the corporation itself was subject to income tax. Some fact must be found which justifies subjecting taxpayers to a further imposition.

The Tax Court concluded this transaction was not carried on at arm's length. But that formula is deceptive. The statutes sets up no such test unless it results in an actual receipt of money or a constructive receipt of financial or economic advantage.

However, this Court will not usurp the function of the Tax Court. That tribunal should find the facts. The cause is remanded, however, because of the errors of law above noted.

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[9] This decision is discussed in 4 Roehner on Federal Taxation, par. 8, September 26, 1958.

[10] 3 Roehner on Federal Taxation, paragraphs 127 and 131, June 13, 1958.

*Hippodrome Amusement Company*

The question whether E. Royce received a dividend from Hippodrome Amusement Company is a simple one.

Royce was one of four shareholders therein. He owned 218 shares, constituting about 61 per cent of the stock in 1945. On December 28 of that year, he received $20,000.00 from the corporation, which was carried on the books of the corporation as a loan. He had not repaid this amount at date of hearing. No note or other evidence of indebtedness had been executed nor interest paid. The government does not contend that this entry in the corporate books is conclusive. Neither B. Royce, brother of E. Royce, who owned 111 shares, nor Stephen Bartel, who owned 5 shares, received dividends. Niederkrome, brother-in-law of E. Royce, who owned 19 shares, received $400.00 in 1948 under circumstances similar to those under which E. Royce received $20,000.00.

The Tax Court held this disbursement was a dividend. As a question of fact, this Court accepts the judgment. If the question be viewed as one of law, we affirm this decision. The evidence need not be reviewed, since there was sufficient to support the finding.

*Yellow Cab of Oregon*

Dora Royce was the wife of E. Royce. On July 31, 1942, Royce transferred to her 14,000 shares, slightly less than half of the stock he owned, in Yellow Cab Incorporated, an Oregon corporation. In August, 1942, the corporation was dissolved, and a partnership was organized where each partner kept the same percentage of ownership as had been represented by stock in the former corporation. The evidence shows that the company was actually managed by E. Royce. It is true, owing to numerous other activities, he only spent about half of his time there.

Dora Royce regularly acted for the partnership as a checker. She checked the conduct of the drivers, the appearance of their uniforms, the condition of the cabs and the number of passengers carried. She checked at hotels, stands, depots and other places where cabs regularly picked up or discharged passengers. Her observations were recorded in reports which she filed at the office. The hours devoted by Dora to her checking varied. Often she would work all day. On other occasions she would work less. At times she did checking in the evenig. She was experienced in her work because she had performed the same services for the prior corporation. Now and then E. Royce did some checking. In the absence of Dora's services, the partnership would have had to employ a checker to do the checking. Dora also attended conferences of the partners and expressed her views.

The Tax Court affirmed the determination of the Commissioner that Dora was not a bona fide partner in this business. This finding is correct and will not be disturbed. The activities of Dora were such that any wife who had the interests of her husband's business at heart might perform. It must be remembered that by law she had a one-half interest in the proceeds. Her expenditures were for family purposes. Besides, she "loaned" a great part of the earnings of this business, ostensibly allocated to her, to her husband to invest in another venture.

The determination of the Tax Court on this item was correct.

*Yellow Cab of Seattle*

The Yellow Cab Company of Seattle, a Washington corporation, presents a situation parallel to that of the Yellow Cab Company of Oregon, and reinforces the finding there. Dora acquired a capital interest in Yellow Cab of Seattle through a gift made by her husband, E. Royce, on April 20, 1944. As was the Oregon corporation, the Wash-

ington corporation was dissolved and a partnership formed simultaneously on May 1, 1944. The firm consisted of ten members. The interest of Dora was about 7 per cent and that of E. Royce about 5 per cent of the total after the gift. Neither of the two was active in the business. Another partner was in direct charge of the enterprise and performed all the duties of management. On the same day as the gift to his wife, April 20, 1944, E. Royce declared himself trustee of about 13 per cent of the total stock for his minor daughter, Eunice, who was living at his home at the time and continued so until she went to the University of Oregon in 1947. She was in school until 1951, and was married in 1952. E. Royce drew $186,046.21 out of the earnings of the trust from January 1, 1944, to December 31, 1949, leaving a balance of $19,108.73 in the account. The withdrawals were spent for the following purposes:

| | |
|---|---|
| Payment of federal and state taxes | $ 89,464.96 |
| Purchase of government bonds | 281.25 |
| Payment of personal expenses of Eunice Royce | 2,200.00 |
| Loans to or for E. Royce | 94,100.00 |
| Balance left in account | 19,108.73 |
| Total | $205,154.94 |

The loans to E. Royce totaled $87,000.00 and have never been repaid. All are now evidenced by three renewal notes bearing 3 per cent interest. Eunice M. Royce had no interest in the partnership. The funds were those of her father, who was obligated to support her. She performed no services for the partnership during these years. So far as the record shows, she was never in Seattle.

The Tax Court held that Dora Royce was not a bona fide partner in the Seattle Yellow Cab Company. It was also held that the so-called "trust" for Eunice was invalid for tax purposes, since its object was to

siphon off income for the benefit of E. Royce. Both these findings were, factually and legally correct. There was substantial evidence to support each.

Affirmed in part and remanded in part.

(Endorsed:) Opinion. Filed Nov. 10, 1958.
Paul P. O'Brien, Clerk.

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## APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT.

No. 15724

FRED C. NIEDERKROME, ET AL.,
*Petitioners,*

vs.

COMMISSIONER OF INTERNAL REVENUE,
*Respondent.*

### Judgment

Upon Petition to Review Decisions of the Tax Court of the United States.

This cause came on to be heard on the Transcript of the Record from The Tax Court of the United States, and was duly submitted;

On consideration whereof, it is now here ordered and adjudged by this Court, that the Decisions of the said Tax Court of the United States in this cause, be, and hereby are affirmed in part and remanded in part.

(ENDORSED) Judgment

Filed and entered: November 10, 1958

PAUL P. O'BRIEN, *Clerk.*

ILE COPY.

Office-Supreme Court, U.S.
FILED
MAR 6 1959
JAMES R. BROWNING, Clerk

No. 685

# In the Supreme Court of the United States

OCTOBER TERM, 1958

EZRA ROYCE, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT*

## BRIEF FOR THE RESPONDENT IN OPPOSITION

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498437—59——1

# In the Supreme Court of the United States

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COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT*

## BRIEF FOR THE RESPONDENT IN OPPOSITION

### OPINIONS BELOW

The opinion of the Court of Appeals (III R. 633–643; Pet. 1a–13a) is not yet officially reported. The memorandum findings of fact and opinion of the Tax Court (I R. 216–296) are not officially reported.

### JURISDICTION

The judgment of the Court of Appeals was entered on November 10, 1958. (III R. 644; Pet. 13a.) The petition for certiorari was filed on February 5, 1959. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

### QUESTION PRESENTED

Whether taxpayer's wife Dora was a bona fide member of the Yellow Cab Company partnerships of Portland and Seattle.

## STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) [As amended by Sec. 1, Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof; or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U.S.C. 1952 ed., Sec. 181.)

## STATEMENT

There were three family partnership problems involved in the instant case before the Tax Court and the Court of Appeals. The first involved the validity of a so-called partnership between the taxpayer, Ezra

Royce, and his wife, Dora, in the Yellow Cab Company of Portland, the second involved the same parties in the Yellow Cab Company of Seattle, and the third involved the so-called partnership interest of the Eunice Royce Trust in the Yellow Cab Company of Seattle.[1] The Tax Court and the Court of Appeals for the Ninth Circuit both affirmed the Commissioner's determination that all income resulting from the purported interests of Dora and the Eunice Royce Trust was taxable to Ezra Royce. The taxpayer, Ezra Royce, does not now question the correctness of the determination that the Eunice Royce Trust was not a bona fide member of the Seattle partnership, but rather directs his petition solely to the validity of his wife's interests in both Yellow Cab Company partnerships. The taxable years involved are 1944 through 1947. (I R. 59–103.) The pertinent facts, as found by the Tax Court in regard to these issues (I R. 263–278), may be summarized as follows:

Prior to August 1, 1942, Yellow Cab Incorporated was an Oregon corporation engaged in the operation of a taxicab business in Portland, Oregon. On August 1, 1942, the corporation was liquidated and dissolved. On the same date, a partnership under the name of Yellow Cab Company (hereinafter called Portland partnership) was formed to operate the business formerly conducted by the corporation. One day prior to the dissolution of the corporation, Ezra Royce transferred 14,000 shares of the corporate stock to his wife, Dora F. Royce. This transfer repre-

[1] Eunice Royce is the daughter of Ezra and Dora Royce.

sented slightly less than half of the shares of stock formerly held by him. The transfer of the stock to Dora was made in anticipation of the planned dissolution of the corporation and the simultaneous formation of the partnership, and the purpose of the transfer was to qualify Dora for admission to the partnership. (I R. 263.)

Under the Portland partnership agreement, Ezra's interest was 26.1575 percent and Dora's interest was 23.06 percent.[2] Profits and losses were to be borne in proportion to partnership interests. The agreement provided that each of the partners was to have an equal voice in the control and operation of the business. (I R. 265.)

Prior to April 20, 1944, Yellow Cab Company of Seattle was a Washington corporation engaged in the operation of a taxicab business in Seattle, Washington. Ezra Royce owned 1,402½ shares of the 5,500 shares which were issued and outstanding. On May 1, 1944, the Yellow Cab Company was liquidated and dissolved. On the same date, May 1, 1944, a partnership of the same name (hereinafter called Seattle partnership) was formed to operate the business formerly conducted by the corporation. (I R. 266–267.)

On April 20, 1944, immediately prior to the dissolution of the Seattle corporation, Ezra Royce transferred 402½ shares of the corporate stock to his wife, Dora. At the same time, he transferred 700 shares of the stock to himself as trustee for his minor daughter,

[2] The remaining interests were held by Ezra's brother, B. Royce, 26.1575 percent, his wife Isabelle, 23.06 percent, and two employees, 1.565 percent. (I R. 265.)

Eunice Royce, then fourteen or fifteen years of age. He retained 300 shares of stock for himself. The transfers of the stock to Dora F. Royce, and to himself as trustee for Eunice Royce, were made in anticipation of the planned dissolution of the corporation and the simultaneous formation of the partnership, and the purpose of the transfers of stock was to qualify Dora and the trust for admission to the partnership. Gift tax returns were filed covering the gifts of stock in the Seattle corporation to both Dora and the trust. (I R. 267.)

The Seattle partnership agreement provided that profits and losses were to be borne in proportion to partnership interests (I R. 269–270); and decisions on partnership matters were to be made by a majority in interest of the partners. (I R. 269.)

Both partnerships kept their books and prepared their tax returns on an accrual basis of accounting during all the years in question. Ezra Royce was the most active partner in the Portland partnership. He made the important decisions as well as the day-to-day decisions involved in the operation of the business. He was in charge of the office, and his supervision and management included the shop and garage personnel. Dora devoted some time to checking the drivers and cars at the stands, boats, depots and any place in Portland where the cabs came frequently to pick up or discharge passengers. She also checked the appearance and condition of uniforms, cleanliness, number of passengers carried and made written reports on these matters to the office. On Schedule I of the partnership returns filed by the Portland partner-

ship for the years 1946 through 1949, no percentage of time devoted to the business by Dora is indicated. Duties similar to those rendered by Dora for the Portland partnership were rendered by an employee of the Seattle partnership for that firm. (I R. 271–272.)

During the years 1944 through 1947, Dora withdrew $171,434.76 and Ezra $201,479.93 from the Portland partnership. (I R. 272.) The withdrawals from the Seattle partnership were as follows (I R. 272–273):

| Year | *Dora F. Royce* | *E. Royce* |
|---|---|---|
| 1945 | $41,622.53 | $30,994.97 |
| 1946 | 19,662.53 | 14,644.97 |
| 1947 | 12,342.53 | 9,194.97 |
| 1948 | 12,342.53 | 9,194.97 |
| 1949 | 5,022.53 | 3,744.97 |
| Total | 90,992.65 | 67,774.85 |

At the end of 1947, the Portland partnership's accumulated earnings distributable to Dora exceeded her withdrawals by $35,434.76, and those distributable to Ezra exceeded his withdrawals by $38,395.26. At the end of 1949, the Seattle partnership's accumulated earnings distributable to Dora and Ezra exceeded their withdrawals by the amounts of $18,733.16 and $14,008.75, respectively. (I R. 273.)

The foregoing withdrawals by Dora were in the form of checks made payable to her. Checks so issued to her by the Portland partnership in 1944, in the aggregate amount of $48,777.75, were endorsed in blank. Another check issued to her by the Portland partnership on February 23, 1945, in the amount of $11,530, was also endorsed in blank by Dora and paid by the drawee, the United States National Bank, on April 3, 1945. All other checks issued to Dora by the Portland partnership and all those issued to her by

the Seattle partnership, totaling $170,479.59, were endorsed in blank both by her and by Ezra Royce. (I R. 273.)

A substantial portion of the partnership earnings distributed to Dora by both partnerships was expended in payment of state and federal taxes. The amounts so expended by Dora for federal taxes for the years 1944 to 1947 were as follows (I R. 274):

| *Year* | *Amount* |
|---|---|
| 1944 | $29,783.72 |
| 1945 | 57,315.46 |
| 1946 | 51,721.22 |
| 1947 | 29,454.14 |
| Total | 168,284.54 |

A portion of the distributions made to Dora by both partnerships was expended by her for such items as (I R. 275):

| *Item* | *Approximate cost* |
|---|---|
| 2 Fur Coats | $1,850 |
| 2 Chrysler Autos | 8,000 |
| Plymouth and Cadillac | Unknown |
| Exercycle | 350 |
| Silverware | 1,800 |
| Lace Cloth | 400 |
| Government Bonds | 7,000 |
| Missouri-Pacific Stock | 4,500 |
| House Improvements | 18,000 |

In addition to the above amounts, a total of approximately $70,000 was loaned to Ezra to be invested in Alder Gold-Copper Company, a company in which, in 1947 and years subsequent thereto, he was interested. Other amounts were given to Ezra to reimburse him for payments he had made for Dora. (I R. 275.)

After trial, the Tax Court, on the basis of considerable oral testimony, held that Dora was not a bona

fide member of the Portland and Seattle partnerships during the taxable years for income tax purposes, and that the Commissioner had properly included in the income of Ezra the partnership profits reported by her. (I R. 275.)

In affirming these holdings, the Court of Appeals held that these findings of fact by the Tax Court were correct and would not be disturbed on appeal. (III R. 641–643; Pet. 10a–13a.)

## ARGUMENT

This case presents no more than a question of fact. The court below correctly affirmed the Tax Court's determination, there is no conflict with the decision of another circuit, and no occasion for further review.

1. This Court, in *Commissioner* v. *Culbertson*, 337 U.S. 733, 742, set forth the ground rules applicable to taxation of family partnerships. Thus, the test is whether, considering all the facts—the agreement, the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purposes for which it is used, and any other facts throwing light on their true intent—the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise. The Tax Court, after carefully studying all of the facts involved in this case in the light of such criteria, came to the conclusion (I R. 278) that "the parties in-

volved at no time really and truly intended Dora to be a bona fide partner in carrying on the business of the Portland and Seattle partnerships." Upon review, the Ninth Circuit properly held that this factual determination was correct. (III R. 642–643; Pet. 11a–13a.)

The situation here is one where a purported partner has not contributed vital services, has not participated in the management and control of the business, and has not contributed "original capital" to the partnership. While these factors do not as a matter of law under the *Culbertson* case suffice to provide an automatic formula for the objective determination of family partnership cases, it is recognized that they do have "the effect of placing a heavy burden on the taxpayer to show the bona fide intent of the parties to join together as partners." *Commissioner* v. *Culbertson, supra,* p. 744; *Wisdom* v. *United States,* 205 F. 2d 30 C.A. 9th); *Feldman* v. *Commissioner,* 186 F. 2d 87, 90–91 (C.A. 4th). The circumstances attendant to Dora's purported interests in both of these partnerships show that prior to the formation of the partnerships her husband, the taxpayer, was a stockholder in the Yellow Cab corporations of Portland and Seattle. In both instances the taxpayer gave Dora stock of the corporations pursuant to and in anticipation of the plan to dissolve the corporations and transfer the assets to the partnerships. These stock transfers were made contingent upon her joining the partnerships and for the sole purpose of qualifying her for admission thereto. (I R. 277; II R. 428–429.) After the corporations were dissolved and the assets trans-

ferred to the partnerships, the conduct of the businesses remained unchanged, the same persons continued to operate and control them as had done so before the formation of the partnerships. The taxpayer failed to convince the courts below that there were any business purposes for taking Dora into the partnership,[3] and this Court has held that to comprise a valid partnership for tax purposes the parties must intend to join together in good faith "and acting with a business purpose." *Commissioner* v. *Culbertson, supra,* p. 742. Of course, the adoption of a family partnership for the sole purpose of splitting income is not acting with a business purpose, for "keeping down taxes is not of itself 'business'." *Slifka* v. *Commissioner,* 182 F. 2d 345, 346 (C.A. 2d). Accord: *Smith* v. *Westover,* 237 F. 2d 201 (C.A. 9th); *Parker* v. *Westover,* 248 F. 2d 490 (C.A. 9th).

Dora did not exercise any real dominion or control over her so-called investments in the partnerships and did not "through that control influence[s] the conduct of the partnership and the disposition of its income." *Commissioner* v. *Culbertson, supra,* p. 747. While both she and her husband testified that she participated in the management and control of both partnerships, the Tax Court was not bound to accept this testimony by interested witnesses. This is particularly so when one considers the statements in

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[3] Compare *Jones* v. *Baker,* 189 F. 2d 842 (C.A. 10th), where the taxpayer gave his wife a one-half interest in his holdings because he was in the armed services, about to be sent overseas, and desired to have his affairs in order so that his wife would be provided for should he not return.

certain of the partnership returns signed and sworn to by taxpayer indicating that Dora performed no services for the partnerships. (I R. 277.) Another important criterion in determining whether or not Dora was a bona fide partner is whether she "is free to, and does, enjoy the fruits of the partnership." *Commissioner* v. *Culbertson*, *supra*, p. 747; *Sellers* v. *Commissioner*, 218 F. 2d 380 (C.A. 9th). The facts show clearly that taxpayer controlled the partnership earnings distributed to his wife. As the Ninth Circuit stated (III R. 642; Pet. 11a):

> Her expenditures were for family purposes. Besides, she "loaned" a great part of the earnings of this business, ostensibly allocated to her, to her husband to invest in another venture.

Thus, the principles set forth by this Court in *Commissioner* v. *Tower*, 327 U.S. 280; *Lusthaus* v. *Commissioner*, 327 U.S. 293; *Lucas* v. *Earl*, 281 U.S. 111; *Helvering* v. *Clifford*, 309 U.S. 331; *Helvering* v. *Horst*, 311 U.S. 112, and reaffirmed in *Culbertson*, are applicable. Here the purported gift, whether or not technically complete, made no substantial change in the economic relations of the Royce family. The result of the transactions was no more than a paper reallocation of income among family members, of no effect for purposes of federal taxation. The status quo of the family vis-a-vis the income was retained.

2. Analysis of taxpayer's petition makes it apparent that he is attempting to urge upon this Court the very type of mechanical determination of the family partnership question which was condemned in *Culbertson*. Thus, in essence, his argument is that

because Dora performed certain services[4] in connection with the Portland partnership, because neither she nor the taxpayer performed any services in connection with the Seattle partnership, because the gifts of capital to Dora from taxpayer might be valid under state law, she must be considered a bona fide partner for tax purposes in both partnerships. But these factors, like all others, can do no more than throw light upon the true intent of the parties—whether in good faith and acting with a business purpose they intended to join together in the present conduct of the enterprise. The Tax Court, applying the proper criteria, determined this question of fact, and the Court of Appeals correctly affirmed this decision since it was not clearly erroneous.

## CONCLUSION

It is respectfully submitted that the petition for a writ of certiorari should be denied.

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[4] These services, upon which taxpayer places great importance, consisted of checking cabs and drivers, and were of such a nature that they could be performed while shopping downtown or driving along the street. The Tax Court termed them "relatively inconsequential." (I R. 277.)

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No. 685

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1958

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EZRA ROYCE, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

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## REPLY BRIEF FOR PETITIONER

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We respectfully submit that the Commissioner's brief in opposition has not obviated the need for certiorari if the courts below are to be guided by intelligible rules of law. To indulge in such obscurities as "the true intent of the parties" (Resp. 12) is merely to resort to "anodynes for the pains of reasoning." Cf. *Commissioner* v. *Sansome*, 60 F. 2d 931, 933 (2d Cir. 1932), *cert. denied*, 287 U. S. 667 (1932). The obscurities do not become less elusive when the Commissioner pretty much concedes that Dora performed services for the Portland partnership, that the petitioner did not render any services to the Sea the partnership, and that

Dora acquired capital interests in both by valid gifts. (Resp. 11-12.) Indeed, the additional arguments which the Commissioner makes fortify our view that certiorari should be granted. For present purposes it seems enough to comment on only two aspects of these arguments.

In an effort to justify the decision below, the Commissioner summarizes the Tax Court's findings (Resp. 3-7), and then blandly proceeds to say that the Court of Appeals approved those findings. (Resp. 7-8.) In other words, he discreetly disregards the fact that the Court of Appeals rejected the Tax Court's findings on Dora's services. (Pet. 10.) As the Commissioner tries to put it, by way of a mere footnote, "These services, upon which taxpayer places great importance, consisted of checking cabs and drivers, and were of such a nature that they could be performed while shopping downtown or driving along the street. The Tax Court termed them 'relatively inconsequential'." (Resp. 12, n. 4.)

Obviously, what the Commissioner is attempting to do is to rationalize the decision below on the basis of findings which the Court of Appeals refused to accept. We need hardly add that the decision below must stand or fall on the facts as the Court of Appeals understood them, not on the facts as the Commissioner would like them to be. The Court of Appeals made its own specific findings on Dora's services, and these findings amply emphasize that Dora "regularly acted for the partnership as a checker." (Pet. 10-11.) And even the Tax Court agreed that her services were similar to those normally performed by a regular employee. (Pet. 10.)

2. The Commissioner contends that a wife cannot qualify as a partner unless she joins the firm for some "business purpose." (Resp. 10.)[1] However, it is well settled that an individual may become a partner through the acquisition of a capital interest or a contribution of services, regardless of whether his becoming a partner serves a "business purpose." See *Hanslee* v. *Whitson*, 200 F. 2d 538, 540 (6th Cir. 1952); *Maloney* v. *Tunnell*, 218 F. 2d 705, 707 (3d Cir. 1955); *Whayne* v. *Glenn*, 222 F. 2d 549, 551 (6th Cir. 1955). We are only saying what the Commissioner himself has said. In the Commissioner's very own words, "an individual is entitled fully to dispose of his or her property so far as the income tax law is concerned, and may give or sell interests in a business to members of his family. The question with which the law concerns itself is whether the individual has really done so. There is no requirement that intra-family gifts be motivated by a business purpose, which frequently they would not have, before the donee may be recognized as the owner, for income tax purposes, of the property given to him, and the same is true of other antecedent family transactions." Mim. 6767, 1952-1 Cum. Bull. 111, 117.

Unfortunately, the present case is still another example of what too often occurs in taxation. The Commissioner says one thing for purposes of administration, and then says exactly the opposite for purposes of litigation. Such convenient contradictions

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[1] The Commissioner insinuates that Dora was made a partner simply to reduce income taxes. (Resp. 10.) There is no such suggestion in either opinion below, nor is there an iota of evidence to this effect.

sufficiently indicate that the Commissioner is in need of further guidance by this Court.

Respectfully submitted,

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